

BANKRUPTCY BASICS

*Public Information Series
Bankruptcy Judges Division
Administrative Office
of the United States Courts*

August, 1998

While the information presented in this pamphlet is accurate as of the date of publication, it should not be cited or relied upon as legal authority. It should not be used as a substitute for reference to the United States Bankruptcy Code (title 11 United States Code) and the Federal Rules of Bankruptcy Procedure, both of which may be reviewed at local law libraries, or to local rules of practice adopted by each bankruptcy court. Finally, this pamphlet should not substitute for the advice of competent legal counsel. For additional copies, please contact the Bankruptcy Judges Division, Administrative Office of the United States Courts, (202) 273-1900.

BANKRUPTCY BASICS

A Public Information Series of the Bankruptcy Judges Division

THE PAMPHLET

The Bankruptcy Judges Division's Public Information Series pamphlet provides basic information to debtors, creditors, court personnel, the media, and the general public on different aspects of the federal bankruptcy laws. The series is also designed to provide individuals who may be considering bankruptcy with a basic explanation of the different chapters under which a bankruptcy case may be filed and to answer some of the most commonly asked questions about the bankruptcy process.

This pamphlet provides general information only. While every effort has been made to ensure that the information contained in it is accurate as of the date of publication, it is not a full and authoritative statement of the law on any particular topic. The information presented in the pamphlet should not be cited or relied upon as legal authority and should not be used as a substitute for reference to the United States Bankruptcy Code (title 11, United States Code) and the Federal Rules of Bankruptcy Procedure.

Most importantly, the pamphlet should not substitute for the advice of competent legal counsel or a financial expert. Neither the Bankruptcy Judges Division nor the Administrative Office of the United States Courts can provide legal or financial advice. Such advice may be obtained from a competent attorney, accountant, or financial adviser.

THE PROCESS

Article I, Section 8, of the United States Constitution authorizes Congress to enact "uniform Laws on the subject of Bankruptcies." Under this grant of authority, Congress enacted the "Bankruptcy Code" in 1978. The Code, which is codified as title 11 of the United States Code, has been amended several times since its enactment. It is the uniform federal law that governs all bankruptcy cases.

The procedural aspects of the bankruptcy process are governed by the Federal Rules of Bankruptcy Procedure (often called the "Bankruptcy Rules") and local rules of bankruptcy. The Bankruptcy Rules contain a set of official forms for use in bankruptcy cases. The Bankruptcy Code and Bankruptcy Rules (and local rules) set forth the formal legal procedures for dealing with the debt problems of individuals and businesses.

There is a bankruptcy court for each judicial district in the country. Each state has one or more districts. There are 90 bankruptcy districts across the country. The bankruptcy courts generally have their own clerk's offices.

The court official with decision-making power over federal bankruptcy cases is the United States bankruptcy judge, a judicial officer of the United States district court. The bankruptcy judge may decide any matter connected with a bankruptcy case, such as eligibility to file or whether a debtor should receive a discharge of debts. Much of the bankruptcy process is administrative, however, and is conducted away from the courthouse. In cases under chapter 7, 12, or 13, and sometimes in chapter 11 cases, this administrative process is carried out by a trustee who is appointed to oversee the case.

A debtor's involvement with the bankruptcy judge is usually very limited. A typical chapter 7 debtor will not appear in court and will not see the bankruptcy judge unless an objection is raised in the case. A chapter 13 debtor may only have to appear before the bankruptcy judge at a plan confirmation hearing. Usually, the only formal proceeding at which a debtor must appear is the meeting of creditors, which is usually held at the offices of the United States trustee. This meeting is informally called a "341 meeting" because section 341 of the Bankruptcy Code requires that the debtor attend this meeting so that creditors can question the debtor about debts and property.

A fundamental goal of the federal bankruptcy laws enacted by Congress is to give debtors a financial "fresh start" from burdensome debts. The Supreme Court made this point about the purpose of the bankruptcy law in a 1934 decision:

[I]t gives to the honest but unfortunate debtor...a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.

Local Loan v. Hunt, 292 U.S. 234, 244 (1934). This goal is accomplished through the bankruptcy discharge, which releases debtors from personal liability from specific debts and prohibits creditors from ever taking any action against the debtor to collect those debts. This pamphlet describes the **Discharge in Bankruptcy** in a question and answer format, discussing the timing of the discharge, the scope of the discharge (what debts are discharged and what debts are not discharged), objections to discharge, and revocation of the discharge. It also describes what a debtor can do if a creditor attempts to collect a discharged debt after the bankruptcy case is concluded.

There are five basic types of bankruptcy cases provided for under the Bankruptcy Code, each of which is discussed in this pamphlet. The cases are traditionally given the names of the chapters that describe them.

Chapter 7, entitled **Liquidation**, contemplates an orderly, court-supervised procedure by which a trustee collects the assets of the debtor's estate, reduces them to cash, and makes distributions to creditors, subject to the debtor's right to retain certain exempt property and the rights of secured creditors. Because there is usually little or no nonexempt property in most chapter 7 cases, there may not be an actual liquidation of the debtor's assets. These cases are called "no-asset cases." A creditor holding an unsecured claim will get a distribution from the bankruptcy estate only

if the case is an asset case and the creditor files a proof of claim with the bankruptcy court. In most chapter 7 cases, the debtor receives a discharge that releases the debtor from personal liability for certain dischargeable debts. The debtor normally receives a discharge just a few months after the petition is filed.

Chapter 13, entitled **Adjustment of Debts of an Individual With Regular Income**, is designed for an individual debtor who has a regular source of income. Chapter 13 is often preferable to chapter 7 because it enables the debtor to keep a valuable asset, such as a house. It is also favored because it allows the debtor to propose a “plan” to repay creditors over time—usually three to five years. At a confirmation hearing, the court either approves or disapproves the plan, depending on whether the plan meets the Bankruptcy Code’s requirements for confirmation. Chapter 13 is very different from chapter 7, since the chapter 13 debtor usually remains in possession of the property of the estate and makes payments to creditors, through the trustee, based on the debtor’s anticipated income over the life of the plan. Unlike chapter 7, the debtor does not receive an immediate discharge of debts. The debtor must complete the payments required under the plan before the discharge is received. The debtor is protected from lawsuits, garnishments, and other creditor action while the plan is in effect. The discharge is also considerably broader (i.e., more debts are eliminated) under chapter 13 than the discharge under chapter 7.

Chapter 11, entitled **Reorganization**, ordinarily is used by commercial enterprises that desire to continue operating a business and repay creditors concurrently through a court-approved plan of reorganization. The chapter 11 debtor has the exclusive right to file a plan of reorganization for the first 120 days after the order for relief and must provide creditors with a disclosure statement containing information adequate to enable creditors to evaluate the plan. The court ultimately approves (confirms) or disapproves the plan of reorganization. Under the confirmed plan, the debtor can reduce its debts by repaying a portion of its obligations and discharging others. The debtor can also terminate burdensome contracts and leases, recover assets, and rescale its operations in order to return to profitability. Under chapter 11, the debtor normally goes through a period of consolidation and emerges with a reduced debt load and a reorganized business.

Chapter 12, entitled **Adjustment of Debts of a Family Farmer with Regular Annual Income**, provides debt relief to family farmers with regular annual income. The process under chapter 12 is very similar to that of chapter 13 under which the debtor proposes a plan to repay debts over a period of time—no more than three years unless the court approves a longer period, not exceeding five years. There is also a trustee in every chapter 12 case whose duties are very similar to those of a chapter 13 trustee. The chapter 12 trustee’s disbursement of payments to creditors under a confirmed plan parallels the procedure under chapter 13. Chapter 12 allows a family farmer to continue to operate a farm while the plan is being carried out.

Chapter 9, entitled **Adjustment of Debts of a Municipality**, provides essentially for reorganization, much like a reorganization under chapter 11. Only a “municipality” may file under

chapter 9, which includes cities and towns, as well as villages, counties, taxing districts, municipal utilities, and school districts.

This pamphlet also contains a description of liquidation proceedings under the **Securities Investor Protection Act**. Although the Bankruptcy Code provides for a stockbroker liquidation proceeding, it is far more likely that a failing brokerage firm will find itself involved in a SIPA proceeding. The purpose of SIPA is to return to investors securities and cash left with failed brokerages. Since being established by Congress in 1970, the Securities Investor Protection Corporation has protected investors who deposit stocks and bonds with brokerage firms by ensuring that every customer's property is protected, up to \$500,000 per customer.

The bankruptcy process is complex and relies on legal concepts like the "automatic stay," "discharge," "exemptions," and "substantial abuse." Therefore, the final chapter of this booklet is a glossary of **Bankruptcy Terminology** which explains, in layman's terms, most of the legal concepts that apply in cases filed under the Bankruptcy Code.